Tower Federal Credit Union

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Via Email

Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Ref: Comments – 12 CFR Part 704
RIN 3133-AD58
Corporate Credit Unions

Dear Ms. Rupp:

Thank you for the opportunity to respond to the Advanced Notice of Proposed Rulemaking for 12 CFR Part 704. My comments are as follows:

Summary of most important recommendations:

- Raise capital requirements -- at least 7% minimum for total capital.
- Dramatically downsize corporates' balance sheets, particularly by limiting investment activities that are in support of large credit unions.
- Focus on servicing needs not readily available from alternative providers. Focus on the needs of small credit unions since large credit unions have alternatives.
- Eliminate the two-tier system with a wholesale corporate.
- Simplify oversight.
- Focus also on interest rate risk -- a next "big" potential challenge in this environment.

Are the corporates *really* critical?
The preamble appears to indicate that the NCUA assumes that the survival of the corporates is necessary to support the industry. NCUA should study this issue more closely, and in particular understand that corporates are not necessary in serving large credit unions. Tower Federal Credit Union has no critical need for the corporates whatsoever -- we could and have functioned very effectively for years without any significant reliance on the corporates. We have used the corporates for investing excess overnight funds, but this was simply because the corporates offered a marginally higher rate -- we could have easily used other external providers with no meaningful impact to Tower's performance.

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Systemic Risk

The central focus of NCUA's efforts should be identifying ways to reduce and manage systemic risks posed by the corporates. If systemic risk is adequately managed, then individual corporates that make critical mistakes or are unable to adequately meet market needs can simply be allowed to fail.

Systemic risk can be better managed in several ways, including: limiting investment activities, raising capital requirements, focusing on the needs of smaller credit unions, focusing on lines of business that meet critical needs, and simplifying oversight. Some of these issues are interwoven, with potential solutions that mutually support multiple of these purposes at once.

Limiting Investment Activities

Many large credit unions may have supported the corporates in the past as a way to support smaller credit unions indirectly. However having large credit unions utilize the corporates for investment services adds little value compared with external alternatives, and results in the corporates having vastly larger balance sheets (and therefore significantly more systemic risk) than would otherwise be the case.

Solutions should focus on minimizing systemic risks, and should not encourage continued usage of the corporates by large credit unions, or in fact by any credit unions where alternatives are readily available in the marketplace.

The Complexity of Oversight

NCUA should recognize potential lapses in its own oversight of the corporates, and that there may be good systemic reasons for these lapses to continue. The investments businesses that the corporates evolved into were significantly different from that of the rest of the industry, adding a new level of complexity, and judgment and expertise required, that NCUA staff may have lacked.

NCUA should focus on solutions that "keep it simple" in terms of the degree of expertise needed for effective oversight. In particular, to dramatically reduce oversight risk, among other reasons, the corporates should be limited to the same menu of investments as available to natural person credit unions.

Answers to some of the specific questions that the NCUA raised:

Should comprehensive changes to the structure of the corporates system be made?
Yes -- eliminate wholesale layer of the two-tier system, downsize balance sheets, focus on eliminating systemic risks, focus on services that are truly critical (e.g. payments for small credit unions), increase capital requirements, limit investment activities.

<u>Provide a separate charter for corporate credit unions to engage in providing investment services?</u>
No -- creates new structural challenges, does not simplify oversight, and does not get rid of the fundamental risks and risky motivations of today's investment services, that caused the problems.

<u>Establish distinct capital requirements for payment systems risk and the risks of other corporates services?</u>
Yes -- adopt risk-based capital requirements, with an overriding minimum total capital requirement of at least 7%.

<u>Establish a legal and operational firewall between services?</u>
No -- this approach is not reliable to work over time, as the ratings companies and many others have shown. Seek other solutions to minimize risks. Also increases complexity of regulatory oversight.

<u>Should liquidity be considered a core service of the corporates system?</u>
No -- for large credit unions. They have alternatives, which would enable the corporates to vastly downsize risks.
Yes -- for small credit unions. The arguments that they have few good alternatives are probably legitimate

<u>Is there sufficient earnings potential in offering payment systems to support a limited business model that is restricted to payment systems services only?</u>
Do not try to answer this question. Let the market decide. Focus on eliminating major systemic risks, and if the corporates can survive by meeting critical core needs of their constituents, then let them. If they cannot survive by meeting core critical needs, enable a reasonable transition process to let them go out of business. Do not perpetuate a business model that relies on making risky investments, in order to subsidize any businesses that cannot survive based on their own merits.

<u>Should liquidity be considered a core service of the corporates system?</u>
Yes -- but only in the roles of aggregators of investment activities for small credit unions, and possibly provisions of loans to small credit unions. Corporates should be permanently removed from a business model relying on credit evaluations of instruments that (either today or at some point in the future) there are dangers that neither they nor their examiners may understand. The argument has been made that corporates facilitate movements of funds between regions of the country. To the extent that these funds belong to large credit unions, large credit unions can accomplish that function without needing corporates.

<u>Should the NCUA consider limiting a corporate's ability to offer other specific types of products and services in order to preserve and defend the liquidity function?</u>
Yes -- eliminate investment activities for large credit unions, such as for example using the corporates to provide large $ overnight fed funds facilities. Dramatically downsize the corporates balance sheets by requiring large credit unions to utilize other external options that are readily available. Downsizing balance sheets will also lower capital needs.

Should the agency return to defined fields of membership?
No -- if services are limited to serve critical needs of small credit unions, and investments risks are dramatically reduced and simplified (discussed elsewhere in this paper) having choices will discourage inefficiency and enhance responsiveness of the incorporates system in serving small credit unions.
Yes -- **IF** the corporates retained their current investment powers (which I strongly recommend against), then competition between corporates must be eliminated. This will help mitigate (but will not eliminate) the current motivation of corporates taking risks in order to chase yield.

Should corporates meeting certain criteria be allowed to purchase investments with relatively lower credit ratings that otherwise permissible?
No -- corporates have not demonstrated that they have any expertise superior to that of natural person credit unions in managing credit risk. Enabling them to serve this role will also complicate oversight, as examiners may not have the skills and judgment to evaluate activities. Dramatically simplify the problem by limiting corporates to investments that can be made by natural person credit unions.

Should NCUA reduce the investment authorities available?
Yes -- corporates should be limited to the same investment activities as natural person credit unions.

Is there a continuing need for a wholesale corporate credit union?
No -- increases systemic risks, and reduces visibility of risks for all participants. NCUA should seek ways to isolate risks within individual corporates, such that problems experienced in one corporate will not readily spread to others. This can be accomplished by limiting corporates' abilities to invest capital and deposits in each other, and by limiting any operational dependencies among corporates.

Should NCUA consider risk-based capital for corporates?
Yes -- with an overriding requirement of at least 7% total capital.

Should any of the limits to existing authorities be eliminated or reduced?
No -- the corporates have enough challenges without taking on new ones.

Should withdrawal of membership capital be conditioned on the corporate's ability to meet all applicable capital requirements following withdrawal?
Yes – obviously!

Should additional stress modeling tools be required to enhance credit risk management?
Yes -- **IF** corporates retain current investment powers. But recognize that a better solution is to greatly simplify the problem by limiting corporates to the same investment powers as natural person credit unions. Continue to utilize rating agencies, but do not assume that their conflicts of interest and other failures will be cured – test their findings with independent analyses.

Should the NCUA require corporate credit unions to perform net interest income modeling and stress testing?

Yes -- and recognize that in the current rate environment 300 basis points shocks are insufficient. Many credit unions may be subjected to additional strains if the economy recovers, inflation reignites, and interest rates skyrocket. There are good reasons for believing that this scenario is plausible.

I hope you find these perspectives valuable. It may also be worthwhile for you to recognize that these perspectives come from a credit union that is virtually unique in that, without any inside information whatsoever, we concluded over a year ago that we should make substantial withdrawals from the corporate system based on a relatively simplistic analysis of their risks.

Please do not hesitate to ask for additional information or clarification of any of these points – I would be happy to assist in any way that I can.

Sincerely,

Martin Breland

Martin M. Breland
President and CEO